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SUBJECT: CLIMATE CHANGE: AUSTRALIA EMBRACING CLIMATE
PROTECTIONISM?

Classified By: Economic Counselor Edgard Kagan, Reasons 1.4(b)(d)

¶1. (C/NF) Summary. At a recent "Chatham House Rules" seminar for Australian government and academic thinkers on emissions trading, Ross Garnaut, the Australian National University Professor who is heading the climate change review commissioned by the Federal and the State and Territory Governments, said that he would be recommending in his July 4 Draft Report to government that Australia impose some form of tariff at the border to create a "level playing field" in terms of carbon pricing under an emissions trading scheme in ¶2010. Garnaut said his recommendation would apply to developed countries only, but that Australia should seek to work out through the WTO a separate multilateral deal with developing countries that export to tax carbon at a sectoral level, allowing the governments in question to keep revenue but reduce the trade impact of climate change commitments. Garnaut, who is wary of this idea but come to grudgingly accept the that such a tariff may be a political necessity to ensure Australian support for effective action to control emissions, suggested that the interface between emissions caps and global trade was significant enough to potentially stop the entire global process to reduce emissions. End Summary.

BOAT HOUSE OR WOOD SHED?

¶2. (SBU) Econoff attended the fourth "Boat House" discussion series put on the Australian Bureau of Agriculture and Research Economics (ABARE), a series which brings together leading experts in government and industry to discuss, off the record, the latest research findings and policy concerns on topical issues. This seminar dealt with the costs to the Australian economy of climate change, and the imposition of an emissions trading system in 2010. ABARE is a federal government agency that conducts analysis and modeling of influences on Australia's resources and agricultural sectors.

Participants included Australia's Department of Climate Change, the Commonwealth Science and Industry Research Organization, Department of Resources, Energy and Tourism, Department of Agriculture, Fisheries and Forestry, Australian Securities Exchange, and international presenters from USDA, New Zealand Ministry of Agriculture and Forestry, and UK Department of Environment, Food, and Rural Affairs.

¶2. (C/NF) As one of highlight speakers at the discussion, Ross Garnaut, an Australian National University professor who helped design Australia's economic reforms in the 1980s under the Hawke Government and served as Australia's Ambassador to

China in 1986-88, laid out the latest thinking of his Climate Change review process, which plans to release its draft report on July 4. Garnaut has been commissioned by the federal and state governments to conduct a wide-ranging and public review of the economic issues surrounding actions to mitigate climate change, and will issue a final report to government in September. Garnaut first explained the difficulties in modeling the costs and affects of emissions caps in general equilibrium economic models, confirming that the detailed modeling of policy choices has slowed the review significantly and that there had been a decision to release a separate report on modeling outcomes in August. "No functioning model in the world can work out the range of reductions we are talking about," Garnaut claimed, adding that no model currently running can show results that match what has occurred in Europe under their emissions trading scheme.

TRADE: FRIENDS, ROMANS, ETC.

13. (C/NF) Turning away from the modeling question, Garnaut said that the most troubling impact of emissions trading would be on international trade. Calling the interface between trade and constraining carbon in the economy the "dreadful problem," Garnaut said he could easily see a situation develop where the world experiences "ferocious rent seeking that would only be considered blatant protectionism in the past." Nonetheless, Garnaut said his review would recommend in its report that the GOA "accept trade on a level playing field only with those developed countries that have UNFCCC compliant emissions reduction targets." This would appear to contrast with official Australian policy as it now stands. In December 2007 at the Bali Conference, Trade Minister Simon Crean said that countries should be "quite concerned about such systemic threats (carbon equivalency measures) to the international trading system."

14. (C/NF) "Level playing field" measures at the border would not apply to all countries equally, Garnaut suggested. Instead, Garnaut said trade with developing countries would have to be exempted from such tariffs because those countries have currently no specific emissions reduction mandate under the UNFCCC, and may not have under a potential post-2012 framework. Australia's major economic drivers (fossil fuels and commodities) are largely export-oriented, and would find off-shoring to other locations difficult. But producers of domestic goods would also be under pressure against imports, especially those from China and India, that did not also price carbon. Garnaut said he would recommend that, in the absence of specific reduction targets or emissions caps in developing country trade partners, Australia should push for a multilateral framework within the WTO that forces developing countries that export to Australia to "equalize" the carbon price of their exports to developed countries. The developing countries would keep the revenue generated for their own purposes, but if they failed to tax at an adequate level, would face WTO action and lose those revenues. Garnaut did not address the challenge of negotiating such a WTO framework in a timeframe consistent with the ETS implementation in Australia, or whether a post-2012 deal which included some form of commitment by developing countries, but not an outright cap, would be sufficient to avoid doing so.

15. (C/NF) This drew the attention of many at the discussion, and when pressed, Garnaut said he saw no way to avoid such action. Otherwise, he argued, the problem of trade-exposed and emissions intensive industries "alone is enough to stop the world from getting to where we have to go." He suggested that, in his view, and despite WTO Director General Pascal Lamy's protests to the contrary, it will be imperative that the WTO proactively to lay down principles and rules. "This is one area where we may all suffer," Garnaut said, "and one where the disciplines of the WTO on open trade break down." The issue of comparable carbon pricing was almost inevitable, and will be highly disrupting and "corrupting" of the

political and trade system, Garnaut prophesied. "The WTO will not welcome this, but will have to sort out rules for partial support for trade leveling schemes," he concluded. Garnaut had hinted at this determination at a public lecture, attended by 500 people, at the Australia National University Qattended by 500 people, at the Australia National University on June 5. In a response to a question on whether Australia should impose tariffs on goods from countries not pricing carbon, he said that as one of the architects of Australia's turn away from protectionism in the 1980s, he "would be the last person to argue such a position," but that the question of leveling the trade playing field absent a truly global emissions target would have to be considered carefully.

¶6. (C/NF) Garnaut had come to this view reluctantly, according to Ron Ben-David of the Victoria State Department of Premier and Cabinet, who has been seconded to the Federal Treasury to serve as Garnaut's "chief of staff" and principle liaison with the Australian government. Ben-David told Econoff June 16 that Garnaut had taken a hard line against this position as late as November last year, but as the review process has drawn on has come to the reluctant conclusion that only some form of transparent trade-leveling scheme will work. Garnaut is "very worried," Ben-David said, "that climate change will be used to justify a raft of new forms of protectionism." However, with Europe already moving towards such measures, and major climate change legislation in the U.S., including Lieberman-Warner, also exploring the possibility, the review will recognize the reality that this is already happening and not leave Australia completely exposed. "This is not advocacy," Ben-David said, "but reluctant recognition. It is better to get this issue on the table and into the WTO process quickly and in an organized fashion that to see it develop haphazardly and unilaterally." Garnaut has also come to the view that the threat of widespread challenges to free trade principles might be the only "Mutually Assured Destruction" tool that forces all sides to the table in a global climate change deal post-2012, Ben-David said.

CERTAINLY NO CERTAINTY

¶7. (C/NF) At the same seminar, Department of Climate Change Assistant Secretary for Emissions Trading Barry Sterland presented on government progress towards the "green paper" planned to be released in July. Noting that government and industry have worked closely in consultations over the ETS design, Sterland said that industry has not yet taken on board that Australia, as a Kyoto member, has international obligations to consider when thinking about how an Australian ETS should look. He said that while industries were looking for certainty on carbon pricing and international competitiveness, "firms will never have the certainty they want about carbon price, we are after all setting up a market." Finally, Sterland said that the government "has a serious commitment to economic management, but a separate and equal commitment to a lower carbon future." ABARE's Don Gunasekera then presented latest modeling on costs to the Australian economy without emissions mitigation. According to Gunasekera, in a "business as usual" case, Australian economic growth falls by -.4 percent by 2030, -.8 percent by 2050, and then steps off the ledge and drops by -7.3 percent by 2100, when Australia's population is projected to reach 42 million.

COMMENT

¶8. (C/NF) Garnaut's review is not necessarily a determinant of Australian government action, and the Department of Climate Change will release its own green paper on preferred government options for emissions trading in July. However, the Garnaut Review is already seen by many in Australia as the most visible voice on action to mitigate climate change, as witnessed by the Prime Minister saying May 31 that he would "wait for Dr. Garnaut's report," before making any decision on whether petrol would be covered by the ETS. If,

per Garnaut's hints, the report suggests that countries acting to reduce emissions should use trade levers against those not doing so, it will be widely accepted as something that Australia should consider. The recent outcry about rising fuel costs has alerted the Government and Opposition that some support for addressing climate change may erode once the costs to individuals of significant emissions reductions become clear. Depending on the public response to the report (and The Rudd government will likely find itself under pressure to implement "trade leveling" costs against non-carbon pricing nations. End Comment.
Qnon-carbon pricing nations. End Comment.

MCCALLUM